

Message Text

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ACTION EUR-12

INFO OCT-01 EA-09 ISO-00 IO-13 SSO-00 NSCE-00 USIE-00

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FRB-01 H-02 INR-07 INT-05 L-03 LAB-04 NSAE-00 NSC-05

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FM AMEMBASSY ROME

TO SECSTATE WASHDC IMMEDIATE 0778

TREASURY DEPT WASHDC IMMEDIATE

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY BERN

USMISSION EC BRUSSELS

AMEMBASSY LONDON

AMEMBASSY HAGUE

AMCONSUL MILAN

AMVONSUL NAPLES 2899

AMEMBASSY PARIS

USMISSION OECD PARIS

AMEMBASSY TOKYO

UNCLAS SECTION 1 OF 2 ROME 17448

TREASURY PASS WIDMAN 0730 OCTOBER 26; PASS FRB

E.O. 11652: N/A

TAGS: EFIN, IT

SUBJ: OSSOLA DEFENDS SURTAX: PROPOSES MORE TAXES AND SCALA
MOBILE REFORM

REFS: (A) ROME 17431; (B) ROME 17432

1. /SUMMARY/. ON OCTOBER 24 AT FOREX CLUB ITALIANO MEETING

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IN TAORIMA MINFOREIGN TRADE RINALDO OSSOLA DEFENDED GOI'S

RE-INTRODUCTION OF SURTAX ON FOREIGN EXCHANGE PURCHASES ON GROUNDS IT WAS BETTER THAN LIRA DEPRECIATION. OSSOLA ALSO SAID THAT ADDITIONAL 1000 BILLION LIRE IN NEW TAXES WERE NEEDED, MADE PROPOSAL FOR REFORMING SCALA MOBILE (WAGE INDEXATION SYSTEM) AND SUGGESTED SERIES OF ADDITIONAL STABILIZATION MEASURES. END SUMMARY.

2. /SEVEN PERCENT SURTAX ON FOREIGN EXCHANGE PURCHASES/

IN FACE OF WIDESPREAD CRITICISM OF REINTRODUCTION OF SURTAX ON FOREIGN EXCHANGE PURCHASES ONLY FEW DAYS AFTER TERMINATION OF EARLIER TEN PERCENT SURTAX, OSSOLA EXPLAINED THAT ALTERNATIVE TO MEASURE HAD BEEN CLOSING OF FOREIGN EXCHANGE MARKET SIMILAR TO ACTION TAKEN IN JANUARY 1976. /(CORRIERE DELLA SERA/ SUGGESTS THAT THIS WAS, IN FACT, PROPOSED BY BANK OF ITALY.) OSSOLA SAID THAT THIS APPROACH HAD BEEN REJECTED SINCE "THIS WOULD HAVE BEEN INTERPRETED BY EVERYONE AS A TACIT DESIRE ON THE PART OF THE MONETARY AUTHORITIES TO LET THE EXCHANGE RATE DEPRECIATE AND THE RATE WOULD CERTAINLY HAVE FALLEN TO ECONOMICALLY UNJUSTIFIED LEVELS FROM WHICH IT WOULD BE DIFFICULT TO RAISE IT. AT LEAST IN THE SHORT RUN THIS WOULD NOT HAVE SERVED TO REESTABLISH EQUILIBRIUM BETWEEN FOREIGN AND DOMESTIC COSTS, GIVEN THE PERVERSE OPERATION OF THE FEALA MOBILE IN ACCENTUATING INFLATION." OSSOLA ADMITTED THAT SURTAX WAS "ONLY A PATCH ON A GARMENT WHICH IS ALREADY WORN OUT AND NEEDS TO BE REPLACED" AND ADDED THAT "IT WOULD BE A GREAT MISFORTUNE IF THE SURTAX CANNOT BE ELIMINATED BEFORE ITS MAXIMUM TERMINATION DATE".

3. /ADDITIONAL TAXES/ REPORTEDLY OSSOLA INDICATED THAT, IN ADDITION TO TAX AND PUBLIC SERVICE TARIFF RATE INCREASES ALREADY TAKEN, IT WIL BE NECESSARY TO INCREASE TAXES BY ABOUT AN ADDITIONAL 1000 BILLION LIRE. HE SAID THAT "MINISTER OF FINANCE PANDOLFI IS WRACKING HIS BRAIN TO FIND NEW TAX MEASURES. PROBABLY THERE WILL HAVE TO BE SOME CHANGES IN INDIRECT TAXES WHICH ARE TOO LOW IN RELATIONSHIP TO DIRECT TAXES."

4. /WAGE INDEXATION (SCALA MOBILE/) OSSOLA SAID THAT ALL THESE TAX AND TARIFF INCREASES WOULD BE USELESS IF SCALA UNCLASSIFIED

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MOBILE (WAGE INDEXATION SYSTEM) IS NOT MODIFIED SINCE IT "ACCELERATES INFLATION AND THE DEPRECIATION OF LIRA, LEADING TO AN INFLATIONARY SPIRAL WHICH EVEN ENDANGERS DEMOCRATIC INSTITUTIONS." HE ADDED THAT THE GROWING SPREAD BETWEEN PRICE INCREASES IN ITALY AND THOSE ABROAD REFLECTED DIFFERING EVOLUTION OF LABOR COSTS AND THAT UNDER SUCH CONDITIONS IT WAS NOT POSSIBLE TO EXPECT THE FOREIGN VALUE OF THE LIRA TO STABILIZE. OSSOLA MADE FOUR POINT PROPOSAL FOR MODIFYING SCALA MOBILE:

HE SUGGESTED THAT: (1) ABOVE ALL IT WAS NECESSARY TO PREVENT INCREASES IN INDIRECT TAXES FROM AFFECTING SCALA MOBILE WITH FEEDBACK EFFECT ON WAGES AND PRICES. (2) IF INCREASES IN PUBLIC SERVICES TARIFFS ARE MADE ON SELECTIVE BASIS TO PROVIDE FAVORABLE RATES FOR LOW INCOME USERS, LATTER RATES (AND NOT HIGHER GENERAL RATES) SHOULD BE THOSE USED IN CALCULATION OF WAGE ADJUSTMENTS, (3) WAGE INDEXATION ADJUSTMENTS SHOULD BE MADE ONLY EVERY SIX MONTHS INSTEAD OF EVERY THREE MONTHS SO THAT TEMPORARY OR SEASONAL FACTORS ARE NOT PERMANENTLY BUILT INTO WAGES, AND (4) SCALA MOBILE "BASKET" OF GOODS AND SERVICES SHOULD BE REVISED SO THAT INCREASES IN ADMINISTERED PRICES AND IN PUBLIC TARIFFS DO NOT RESULT IN WAGE ADJUSTMENTS WHICH ARE GREATER THAN INCOME GENERATED BY THESE PRICE OR TARIFF INCREASES. OSSOLA SAID THAT IT WAS RIDICULOUS THAT A FIFTY LIRE INCREASE IN PRICE OF NEWSPAPERS, WHICH GENERATES 150 BILLION LIRE IN INCOME FOR NEWSPAPER PUBLISHERS WOULD ALSO RESULT IN INCREASE IN TOTAL WAGE PAYMENTS THROUGH SCALA MOBILE MECHANISM OF 400 BILLION LIRE. ALSO, FIFTY LIRE INCREASE IN URBAN TRANSPORT FARES WOULD RESULT IN INCREASED WAGE BILL OF 650 BILLION LIRE. FINALLY, OSSOLA SUGGESTED THAT EFFECTS OF WORSENING IN ITALY'S TERMS OF TRADE DUE TO INCREASES IN CRUDE OIL OR OTHER COMMODITY PRICES SHOULD NOT BE FED INTO SCALA MOBILE. /CORRIERE DELLA SERA/ ON OCTOBER 25 DESCRIBES OSSOLA PROPOSALS AS TRIAL BALLOON, NOTING CONTINUED STRONG OPPOSITION FROM LABOR UNIONS TO ANY TAMPERING WITH SCALA MOBILE.

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ACTION EUR-12

INFO OCT-01 EA-09 ISO-00 IO-13 SSO-00 NSCE-00 USIE-00

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TREASURY DEPT WASHDC IMMEDIATE
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TREASURY PASS WIDMAN 0730 OCTOBER 26; PASS FRB

E.O. 11652: N/A
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5. /EC URGES REFORM OF SCALA MOBILE/ PICKING UP SCALA MOBILE
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THEME, /LA STAMPA/ ON OCTOBER 25 REPORTS FROM BRUSSELS THAT EC COMMISSION STRONGLY FAVORS ACTION IN THIS AREA, POSSIBLY IN FORM OF COMPLETE BLOCK OF WAGE INDEXATION ADJUSTMENTS FOR SIX MONTH PERIOD. ARTICLE SPECULATES THAT EC HAS ALREADY EXERTED PRESSURE ON GOI ALONG THESE LINES, NOTING THAT EC PRESIDENT ORTOLI HAD JUST RETURNED FROM ROME ON OCTOBER 24 FOLLOWING TALKS WITH PRIME MINISTER ANDREOTTI AND MIN-TREASURY STAMMATI. REPORTEDLY EC EXPERTS BELIEVE THAT BLOCK OF SCALA MOBILE WOULD BE PAINFUL BUT THAT IT WOULD PRODUCE QUICKER RESULTS ON INFLATION THAN OTHER MEASURES TAKEN TO DATE BY GOI AND THAT, IN ABSENCE OF SUCH A MEASURE, SACRIFICES ALREADY ASKED OF ITALIAN PEOPLE WOULD HAVE TO BE BORNE FOR ANOTHER THREE TO FIVE YEARS. /LA STAMPA/ SUGGESTS THAT, IF MORE SEVERE MEASURES ARE NOT TAKEN, EC WILL NOT BE PREPARED TO GRANT NEW CREDIT BEYOND THAT REQUIRED TO OFFSET ITALY'S REPAYMENT OF \$486 MILLION TO UK. ARTICLE SAYS THAT EC EXPERTS ARE PESSIMISTIC ABOUT ITALIAN ECONOMIC PROSPECTS, INCLUDING EMPLOYMENT PROSPECTS, NOTWITHSTANDING 1000 MILLION DOLLAR LOAN THAT EC IS EXPECTED TO GRANT ITALY IN NOVEMBER OR DECEMBER. EVEN WITH LOAN, ITALY'S REAL ECONOMIC GROWTH IN 1977 WOULD ONLY BE THREE PERCENT ACCORDING TO EC EXPERTS AND ITALY WOULD HAVE TO CONTINUE TO SOP UP

4000 BILLION LIRE IN SPENDING POWER PER YEAR FOR SEVERAL YEARS.

6. /OTHER POSSIBLE STABILIZATION MEASURES/ OSSOLA REPORTEDLY SUGGESTED FOLLOWING MEASURES AS POSSIBLE ADDITIONAL WAYS OF BRINGING ITALIAN COSTS INTO LINE WITH THOSE ABROAD: (1) REDUCING SOCIAL INSURANCE COSTS OF BUSINESS BY THEIR PARTIAL ASSUMPTION BY GOVERNMENT ("FISCALIZATION") BUT WITH TAX INCREASES SUCH AS IN VALUE ADDED TAX TO OFFSET THIS NEW BUDGET EXPENDITURE; (2) PERSERVERING IN FIGHT AGAINST EVASION OF TAX AND EXCHANGE CONTROL LAWS AND GRADUALLY ELIMINATING UNNECESSARY PUBLIC AGENCIES, (3) INCREASING SOME PUBLIC SERVICE TARIFFS WHICH HAVE NOT ALREADY BEEN RAISED, SUCH AS URBAN TRANSPORT FARES, (4) DRASTICALLY REFORMING MEDICAL AND HEALTH EXPENDITURES BY REQUIRING AT LEAST TOKEN PAYMENTS FOR MEDICINES, FOR EXAMPLE OF THIRTY PERCENT FOR ORDINARY MEDICINES AND TEN PERCENT FOR MORE SOPHISTICATED ONES, AND (5) EVENTUALLY REQUIRING PUBLIC AGENCIES, THE REGIONS AND OTHER LOCAL GOVERNMENTS TO HOLD THEIR LIQUID FUNDS WITH THE UNCLASSIFIED

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TREASURY. OSSOLA CONCLUDED HIS ADDRESS BY CITING COMPARATIVE FIGURES UNFAVORABLE TO ITALY ON PRICE INCREASES, WAGE RATE INCREASES, UNIT LABOR COSTS AND WAGE BILLS. HE SAID "IN OTHER WORDS, OUR LIVING BEYOND OUR MEANS EXPLAINS THE RETICENCE OF OTHER COUNTRIES IN GRANTING US FURTHER AID."VOLPE

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